UNITED STATES TAX COURT

WASHINGTON, DC 20217

THE CANNON CORPORATION AND SUBSIDIARIES, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	Docket No. 12466-16.

O R D E R

This case was originally on the Court's June 2018 trial calendar for Buffalo. We moved it to a summary-judgment track, and we now have to decide the Commissioner's modified second motion for partial summary judgment.

In it, the Commissioner acknowledges that he must show supervisory approval of a penalty determination. But he does so with a document entirely blacked out because he claims deliberative-process privilege for its contents. To preserve that privilege neither Cannon nor the Court have been allowed to peek behind the mask covering the document that, we are told, contains the required approval.

Does this work?

The answer is no.

Background

The substance of this case arises from Cannon's claim to a deduction for credits under I.R.C. § 179D. The major problem is that Cannon earned these credits in tax years 2007 through 2010, but it claimed them on its tax return for 2011. There are nontrivial reasons for it having done so, but we granted the

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Commissioner's motion for partial summary judgment on this issue. We ruled that the usual rule that a taxpayer has to claim a deduction in the year it earns it does apply.

That left a single issue in the case that still needed to be decided -- whether Cannon is liable for an accuracy-related penalty under I.R.C. § 6662(a) for taking the position it did. The Commissioner then moved for partial summary judgment on this issue.

Part of this motion is about whether Cannon acted reasonably and in good faith in taking the position it did. This is usually a factual question -- and the parties here don't really dispute that too much. We acknowledge that the Commissioner tries to show that there's no dispute, but those kinds of questions need to be aired at trial -- Cannon asserts that its position was reasonable and taken in good faith. We agree with Cannon that this is a factual question and that there's a genuine dispute about who's right.

The more interesting question is whether the Commissioner made it over the procedural hurdles for asserting penalties that we've held the Code forces him to clear. There is first the question of who has the burden of production here. I.R.C. § 7491(c) says that the Commissioner has the burden of production on penalties "in any court proceeding with respect to the liability of any individual." In *NT, Inc. v. Commissioner*, 126 T.C. 191,195 (2006), we held that a corporation is not an individual under I.R.C. § 7491(c). At trial, this would mean that the burden of production would remain on Cannon, which is a corporation.[1] But when the Commissioner moves for summary judgment, he must show that "there is no genuine dispute as to any material fact and that a decision may be rendered as a matter of law." Rule 121(b); *see also Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520, *aff'd*, 17 F.3d 965 (7th Cir. 1994).

What does this mean here?

I.R.C. § 6751(b) provides that no penalty shall be assessed unless the Commissioner shows that "the initial determination of such assessment" was

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[1] We have little doubt that petitioner's counsel will find some way of preserving this issue for decision once the Court resumes normal operations after the current pandemic ebbs.

"personally approved (in writing) by the immediate supervisor of the individual making of such determination . . . ." I.R.C. § 6751(b)(1). In *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017), *aff'g in part, rev'g in part* 109 T.C.M. (CCH) 1206 (2015); and then in *Graev v. Commissioner*, 149 T.C. 485 (2017), *supplementing and overruling in part* 147 T.C. 460 (2016), we learned that this language isn't meant to be taken literally -- it's not the determination of an "assessment" that must be personally approved in writing, but instead the initial "determination" to assert the penalty. *Chai*, 851 F.3d at 221; *see also Graev*, 149 T.C. at 493-95.

We also know that this approval must come no later than the date that the Commissioner issues the notice of deficiency or files an answer or amended answer in which he first asserts the penalty. *See Chai*, 851 F.3d at 221; *Graev*, 149 T.C. at 494-95. But that's only the *latest* time for this approval. The relevant determination may be much earlier. And in *Clay v. Commissioner*, 152 T.C 223 (2019), *appeal docketed*, No. 19-14441 (11th Cir. Nov. 6, 2019), we held that I.R.C. § 6751(b) may require written approval of penalties before the issuance of a notice of deficiency -- in that case when the IRS mailed a letter that formally communicated to the taxpayers proposed adjustments that included penalties and gave the taxpayers their right to protest the proposed penalties. *Clay*, 152 T.C. at 249.

The Commissioner, here, had argued in his second motion for partial summary judgment that he met I.R.C. § 6751's requirement because he could show written approval from a supervisor that preceded the notice of deficiency that he sent to Cannon. But once we released *Clay*, he realized that this was no longer enough, because he had earlier mailed the same sort of letter to Cannon that he'd sent to Clay. He moved for extra time to supplement his motion to respond to this development, which we granted. Cannon now contends that the Commissioner no longer can prove he complied with I.R.C. § 6751(b), which means he can't show that on this issue he would be entitled to judgment as a matter of law.

Discussion

The supervisory approval of the initial determination required under I.R.C. § 6751(b) must be in writing, but there is no particular requirement as to its form.

See Palmolive Bldg. Inv'rs, LLC v. Commissioner, 152 T.C. 75, 86 (2019). There need not be any particular form of signature or even any signature at all. *See Deyo v. United States*, 296 F. App'x 157, 159 (2d Cir. 2008). "The plain language of [I.R.C.] § 6751(b) mandates only that the approval of the penalty assessment be 'in writing' and by a manager . . . ." *PPBM- Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193, 213 (5th Cir. 2018).

There is no genuine dispute that Mark Guenther was the revenue agent assigned to examine Cannon's 2011 return. There is no genuine dispute that Guenther's immediate supervisor was Linda Hussain. There is also no genuine dispute that Guenther prepared a Form 5701 -- titled Notice of Proposed Adjustment -- and a Form 886-A -- titled Explanation of Items -- that proposed to disallow Cannon's claim for taking an I.R.C. § 179D deduction it had earned in previous years on its 2011 return and to assert that Cannon owed a penalty under I.R.C. § 6662(a).

Clay tells us that this was an "initial determination" under I.R.C. § 6751(b), because it was the first formal communication of the IRS's intention to assert a penalty. *See Clay*, 152 T.C. at 249. The forms that Guenther drafted are dated December 9, 2014 and were sent to Cannon shortly thereafter. This means that the Commissioner has to show that Hussain approved Guenther's determination before this date. *See* I.R.C. § 6751(b)(1); *Clay*, 152 T.C. at 249.

This roused a *Chai*ghoul hitherto unseen and, indeed, whose existence had not even been predicted by theory. *See Graev*, 149 T.C. at 512-16 (Holmes, J., concurring).

While there is no particular form that the written supervisory approval must take, it must be clear that the writing actually amounts to managerial approval of the penalty assessment. This is where the Commissioner gets into trouble. He attaches to his motion a November 17, 2014 email from Hussain to Guenther. In the email she tells Guenther that she had reviewed and made changes to the draft Form 886-A that he'd filled out, and she instructed him to make the changes and told him where next to send it within the IRS.

The Commissioner asks us to hold as a matter of law that this Form 886-A with redlined changes satisfies the written approval requirement. But he also claims that this attachment to Hussain's email is protected by the deliberative-

process privilege.[2] This assertion of the deliberative-process privilege may or may not be justified (Cannon hasn't moved for *in camera* review or disclaimed any intent to object to its introduction at trial). But the Commissioner's assertion of the privilege does prevent us from verifying that the changes Hussain recommended or the language that she possibly approved without change would qualify as supervisory approval.

Without being able to see the Form 886-A draft, Cannon makes the reasonable point that this email might just cover editorial changes to Guenther's draft without actually approving the penalty. It also makes the very good point that the Commissioner's assertion of a *pre*decisional privilege means that the drafts were just drafts, and not a final anything, much less the required decision or approval made by a supervisor. It may well be that Hussain made no actual decision to approve Guenther's determination to assert the I.R.C. § 6662 penalty.

In ruling on a motion for summary judgment we must draw inferences in the manner that most favors the nonmoving party. It is therefore

ORDERED that respondent's motion for partial summary judgment and first supplemental motion for partial summary judgment is denied.

The parties should be aware that the Court's next visit to Buffalo was postponed because of the current pandemic. They may expect a teleconference

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[2] The IRS's Internal Revenue Manual defines the deliberative-process privilege as:

> a qualified privilege that protects from disclosure certain statements of advice, deliberation, and recommendation of governmental officials. In order to successfully claim the privilege, the respondent must show that a document is predecisional, *i.e.*, "antecedent to the adoption of an agency policy," and deliberative, *i.e.*, "a direct part of the deliberative process in that it makes recommendations or expresses opinions on legal and policy matters."

I.R.M. § 35.4.6.3.3.1(1).

with the Court to discuss how to get the case ready for trial when the Court resumes normal operations.

(Signed) Mark V. Holmes
Judge

Dated: Washington, D.C.
April 2, 2020